

Message Text

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ACTION EUR-12

INFO OCT-01 ISO-00 CAB-02 CIAE-00 COME-00 DODE-00 DOTE-00

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PA-01 PRS-01 SP-02 SS-15 USIA-06 TRSE-00 STR-04 OMB-01

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INFO AMEMBASSY LONDON

AMEMBASSY PARIS

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C O N F I D E N T I A L SECTION 01 OF 02 BONN 00445

E.O. 11652: GDS

TAGS: EAIR, UK, US, WB

SUBJECT: CIVAIR: IGS FARE INCREASE

REF: STATE 261821

1. SUMMARY: PAA AND BA HAVE SUBMITTED APPLICATIONS FOR AN 11 PERCENT IGS FARE INCREASE (EXCLUDING SUBSIDY) TO THE CAA'S. SINCE THE BRITISH CAA STILL LACKS SOME OF THE NECESSARY SUPPORTING DATA IT HAS NOT BEEN POSSIBLE TO ATTEMPT AN ASSESSMENT OF THE CARRIERS' COMBINED CASE. ON THE BASIS OF PAA'S MATERIAL, HOWEVER, OUR TENTATIVE VIEW IS THAT SOME UPWARD ADJUSTMENT IN FARE LEVELS FOR 1976 MERITS CONSIDERATION. WE PRESUME PAA'S DATA HAS BEEN SUBMITTED TO THE CAB STAFF FOR AN INFORMAL ADVISORY OPINION. END SUMMARY.

2. WE RECEIVED PAA'S NEW APPLICATION AND REVISED JUSTIFICATION FOR AN IGS FARE AND CARGO RATE INCREASE ON DEC. 31. IDENTICAL MATERIAL WAS SUBMITTED SIMULTANEOUSLY TO THE DEPARTMENT (EB/AO). THE PRESENT APPLICATION
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TION REQUESTS AN AVERAGE INCREASE OF 11 PERCENT

EXCLUDING SUBSIDY (TO THE PASSENGER) OR 9.5 PERCENT TO THE AIRLINE (EFFECTIVE FEB. 1). THIS COMPARES TO THE 7.9 PERCENT TO THE PASSENGER (6.7 PERCENT TO THE AIRLINES) ENVISAGED IN PAA/BA'S OCT. 1974 APPLICATION. THE PROPOSED FREIGHT RATE INCREASE HAS SIMILARLY ADVANCED FROM 7.5 PERCENT ACROSS THE BOARD TO 11 PERCENT.

3. IN A COVERING LETTER, PAA DIRECTOR RUNNETTE STRESSES, INTER ALIA, THAT LUFTHANSA RAISED ITS DOMESTIC FARES BY CLOSE TO 10 PERCENT ON NOV. 1, 1975. IGS FARES PER MILE ARE PRESENTLY 43.3 PERCENT BELOW LUFTHANSA'S DOMESTIC TARIFF AND WOULD STILL BE 37 PERCENT LESS IF THE PROPOSED INCREASE WERE GRANTED. RUNNETTE ALSO DISCUSSES SUBSIDIES OBSERVING THAT THE FARE INCREASE TO THE PASSENGER COULD BE REDUCED FROM 11 PERCENT TO 9.5 PERCENT AND STILL YIELD THE AIRLINES THE DESIRED 9.5 PERCENT INCREASE IN REVENUES IF THE FRG AGREED TO INCREASE THE PER PASSENGER SUBSIDY BY A LIKE AMOUNT OR 9.7 PERCENT. HE STRESSES, HOWEVER, THAT PAA WOULD NOT FAVOR DELAYING ACTION ON A FARE INCREASE IN ORDER TO INDUCE THE FRG TO MOVE ON SUBSIDIES.

4. IN REVIEWING PAA'S SUPPORTING MATERIAL, WE FIND AMONG THE POINTS OF PARTICULAR INTEREST THE CARRIER'S ASSERTION THAT THE ROUTE SWAP HAS DILUTED PER PASSENGER YIELD BECAUSE OF THE GREATER NUMBER OF PRO-RATED INTERNATIONAL ORIGIN TRAVELERS CONCENTRATED ON PAA'S FRANKFURT/BERLIN SERVICE. THIS SUGGESTS THERE IS SOME VALIDITY TO THE GERMAN BCATAG REPS' CONTENTION THAT LUFTHANSA'S (LH) HIGH PROPORTION OF PRO-RATED PASSENGERS ON ITS DOMESTIC SERVICE MAKES A COMPARISON OF FARE LEVELS WITH THE IGS AS AN INDICATION OF RELATIVE YIELD MISLEADING. PAA'S AMPLIFICATION OF FUEL COST MOVEMENTS IS ALSO LESS THAN HELPFUL TO ITS CASE SINCE A COMPARISON WITH ITS MARCH 1975 (SUPPLEMENTING ITS OCT. 1974 APPLICATION) FORECASTS AN IGS FUEL PRICE OF 55.98 CENTS PER GALLON FOR THE FIRST FOUR MONTHS OF 1976. THE CURRENT APPLICATION FORECASTS A 51.01 CENT PRICE, DOWN SLIGHTLY FROM 1975 (ABOUT 51.13 CENTS PER GALLON)

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EVEN THOUGH THE LATEST CALCULATION REFLECTS THE RECENT (OPEC) INCREASE IN OIL PRICES.

5. REGARDING OTHER OPERATING EXPENSES SUCH AS FLYING OPERATIONS, PASSENGER SERVICE, ETC., WE HAVE RUN A ROUGH COMPARISON BETWEEN PAA 1976 FORECASTS AND ITS EARLIER EXPERIENCE AS DEMONSTRATED IN APPENDIX H OF THE MARCH 1975 SUBMISSION. THE RESULTS SUGGEST THAT

SAVINGS REALIZED THROUGH THE ROUTE SWAP WILL TEND TO ERODE DURING 1976 WITH TOTAL EXPENSES FORECAST TO INCREASE BY ABOUT TWO PERCENT FROM 1975 LEVELS. AT THE SAME TIME, WITHOUT A FARE INCREASE PAA CALCULATES ITS REVENUES WOULD FALL OFF BY ABOUT FIVE PERCENT. (WITH THE PROPOSED FARE INCREASE REVENUES WOULD STILL ONLY ADVANCE BY ABOUT ONE PERCENT.)

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C O N F I D E N T I A L SECTION 02 OF 02 BONN 00445

THE RESULT, IF NO FARE INCREASE IS GRANTED, WOULD REDUCE PAA'S OPERATING PROFIT SHARPLY FROM \$9.3 MILLION TO \$3.9 OR BY 58 PERCENT (APPENDIX E, P.L). THE SAME TABLE REVEALS THAT PAA'S FORECAST 1976 OPERATING PROFIT - EXPRESSED AS A PERCENTAGE OF REVENUES - WOULD FALL CONSIDERABLY BELOW ITS HISTORIC PERFORMANCE EXCEPT FOR 1974 WHEN THE CARRIER POSTED AN UNCHARACTERISTICALLY LOW 3 PERCENT.

6. EMB CAA MET WITH BRITISH CAA GROVES ON JAN. 7 TO

COMPARE NOTES WITH INCONCLUSIVE RESULTS. GROVES HAD RECEIVED COPIES OF BA'S APPLICATION AND INDIVIDUAL JUSTIFICATION FROM THE UK'S DEPARTMENT OF TRADE (DOT), BUT STILL LACKED THE COMBINED PAA/BA DATA PROVIDED IN APPENDIX F OF PAA'S SUBMISSION. BOTH APPLICATIONS REQUESTED IDENTICAL OR NEARLY IDENTICAL FARE AND CARGO RATE INCREASES, HOWEVER, BA'S MADE NO REFERENCE TO AN EFFECTIVE DATE. OUR CURSORY DISCUSSION OF INDIVIDUAL CARRIER RESULTS LEFT SOME QUESTION IN OUR MINDS REGARD-
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ING THE COMBINED OPERATING PROFIT FIGURE (PRESUMING A FARE INCREASE) PROVIDED BY PAA WHICH IS JUST OVER A PERCENTAGE POINT LESS THAN PAA'S OWN PROFIT. ON THE OTHER HAND GROVES INDICATED BA'S WOULD AT BEST BE NEAR THE BREAK-EVEN POINT. WHILE SOME OF PROBLEM MAY REST WITH THE CARRIERS' VARYING MARKET SHARES WE WILL BE REVIEWING THIS MORE CAREFULLY AS SOON AS GROVES HAS ADDITIONAL DATA.

7. COMMENT: OUR INITIAL IMPRESSION OF THE NEW DATA PRESENTED BY PAA IS THAT SOME LEVEL OF FARE INCREASE MAY WELL BE SUPPORTED BY PAA'S 1976 FORECASTS. WE WOULD BASE THIS VERY TENTATIVE CONCLUSION ON THE DECLINE IN REVENUES EXPECTED DURING NEXT YEAR WHICH WOULD PROVIDE THE CARRIER AN OPERATING PROFIT MARKEDLY BELOW ITS USUAL LEVELS (SEE PARA 5 ABOVE). SEEN FROM PAA'S PERSPECTIVE, IN THE ABSENCE OF A FARE (OR SUBSIDY) INCREASE THE ONLY AVAILABLE MEANS OF IMPROVING ITS PROFIT POSITION WOULD BE FURTHER DRASIC CUTS IN CAPACITY TO FURTHER REDUCE COSTS. ON BALANCE, WE WOULD TEND TO THINK SOME UPWARD ADJUSTMENT IN FARES PREFERABLE TO ANY (NEAR-TERM) ADDITIONAL REDUCTIONS IN IGS SERVICES BEYOND THAT JUSTIFIED BY THE EXPECTED DECLINE IN PASSENGER VOLUME FOR 1976 - BETWEEN THREE AND FIVE PERCENT ACCORDING TO PAA'S CALCULATIONS. MOREOVER, THE LAST IGS FARE INCREASE WAS GRANTED 18 MONTHS AGO - A FACT WE SEE AS SUPPORTING THE AIRLINE'S CASE. WITH RESPECT TO THE DOWNWARD IMPACT ON PASSENGER VOLUME OF THE PROPOSED FARE ADJUSTMENT, BASED ON PAA'S ELASTICITY CALCULATION WE WOULD ESTIMATE A DECLINE OF ABOUT THREE PERCENT DIRECTLY ATTRIBUTABLE TO HIGHER FARES. IF PAA'S FORECAST ON TRAFFIC LEVELS FOR 1976 IS AT ALL IN THE BALL PARK, EVEN WITH A FARE INCREASE THE IGS SHOULD LOSE LESS BUSINESS THAN WAS THE CASE THIS YEAR WHEN TRAFFIC VOLUME FELL OFF BY OVER TEN PERCENT.

8. WE PRESUME, AS IN THE PAST, PAA'S DATA HAS BEEN SUBMITTED TO THE CAB STAFF FOR AN INFORMAL ADVISORY

OPINION. WE WOULD BE PARTICULARLY INTERESTED IN THE
STAFF'S VIEW AS TO WHETHER A SMALLER FARE INCREASE -
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AND THE RESULTANT LESSER DECLINE IN TRAFFIC VOLUME -
MIGHT POSSIBLY ACHIEVE THE SAME GAINS IN REVENUE.
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